

Aruba, May 21, 2014 - Well-meaning governments are killing the continent's startups with kindness. IN A suburban office on the road to Luxembourg airport, a small group of civil servants is busy picking the next generation of European venture capitalists. Every year, hundreds of would-be financiers set out their stalls at the European Investment Fund (EIF), a body financed by the European Union, hoping they will be given money to create the next Facebook. Europe has never been able to muster nearly the same quantity or quality of venture capital (VC) as Silicon Valley. That is frustrating to its politicians, who see venture capitalists as job-creating innovation machines, and love them nearly as much as they loathe other financial types. But investors who put up such capital in other parts of the world, such as pension funds, banks and billionaires, are not especially eager to funnel money to startups battling to thrive in Europe's often hostile business environment. By and large, the politicians' solution has not been to make the environment friendlier to business, thus increasing entrepreneurs' chances of luring private-sector backing. Instead, they have replaced the reticent financiers with state-funded bureaucrats.

Nearly 40% of all the funds pumped into European VC last year came from state-backed sources, up from just 14% in 2007 (see chart). The EIF alone ploughed €600m (\$800m) into VC funds last year, out of a Europe-wide total of €4 billion. On top of this, nearly every country has its own pet program to back chosen venture capitalists.

Despite taxpayers' generosity, few think Europe's VC industry has much chance of attracting American levels of capital from private investors, given its feeble record. Venture capital in Europe has delivered returns of just 2.1% a year since 1990, according to Thomson Reuters, making it perhaps the worst investment class outside Japan (American VC managed around 13%). The 2008 crash, which came just as investors were getting over the fortunes they lost in the internet bubble, sapped what little interest remained. The public cash slushing around VC-land may in fact be repelling private money. Investors turn to VC hoping to attain vast riches by nurturing the next Google or WhatsApp; they are loth to invest alongside governments whose interests lie only partly in turning a profit. State money comes with strings attached, be it an encouragement for venture capitalists (or the companies they finance) to create jobs in particular countries or to focus on certain favored sectors. This is anathema to private investors, who fear their money would be used to pursue political goals. "I understand why governments invest in venture capital, but they are spoiling it for the rest of us," says an endowment-fund boss.

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